

UIL 7428.00-00

**Internal Revenue Service**  
Appeals Office  
401 West Peachtree Street, NW  
Stop 1100-D, Room 1455  
Atlanta, GA 30308-3510

Release Number: 201043053  
Release Date: 10/29/10  
Date: July 29, 2010

**Department of the Treasury**

**Person to Contact:**

**Employee ID Number:**

**Tel:**

**Fax:**

**Form Required to be Filed:**

**In Re:**

**Employer Identification No:**

**Tax Period(s) Ended:**

**Certified Mail**

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). "Recognition of your exemption under Section 501 (c)(3) is revoked effective January 5, 2001."

Our adverse determination was made for the following reasons. A substantial part of your activities consists of providing down payment assistance to home buyers. To finance the assistance you rely on home sellers and other real-estate related businesses that stand to benefit from these down payment assistance transactions. This is considered a substantial non-exempt purpose. In addition, your operations further the private interests of the persons that finance your activities. Accordingly, you are not operated exclusively for exempt purposes described in Section 501(c) 3) and Treas. Reg. Section 1.501(c)(3)-1(d).

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office. Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles Fisher", with a stylized flourish at the end.

Charles Fisher  
Appeals Team Manager

TE/GE Division 450 Golden Gate  
Avenue MS SF 7-4-01 San Francisco,  
California 94102-3412

Taxpayer Identification  
Number:

DATE: March 20, 20XX

ORG  
ADDRESS

Tax Year(s) Ended,  
Person 10 Contract ID Number:

Contact Number,  
Telephone  
Fax:

**Certified Mail -Return Receipt Requested**

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your' exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary. '

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Adverse Action. We will send you a final modification or revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. )(our protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issue*; explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of your letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of your letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sunita Lough Director, EO  
Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit # 1
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Name of Taxpayer ORG EIN:		Year/Period Ended 12/31/20XX

**LEGEND**

ORG = Organization name      XX = Date      State = state      ORG-1 = ORG-1  
 CEO = CEO      DIR-1 & DIR-2 = 1<sup>st</sup> & 2<sup>nd</sup> DIRECTORS      CO-1 & CO-2 = 1<sup>st</sup> & 2<sup>nd</sup>  
 COMPANIES

**ISSUES:**

1. Whether an organization, whose primary purpose is operating a "down-payment assistance" program is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3)?

**FACTS:**

ORG was incorporated in the State of State on January 5, 20XX. The original name of the corporation was the ORG-1. The organization was formed under the nonprofit corporation law of State. The primary purpose was to aid the underprivileged by fostering home ownership. The corporation's initial directors were DIR-1 and DIR-2.

The foundation filed Form 1023 Application for Recognition of Exemption in 20XX. The application was signed by DIR-1, Director, on October 2, 20XX.

In Part II, Question 1 of the application, the organization stated that it was "a newly conceived program to provide assistance, counseling, training and monetary support to allow disadvantaged members of the public to achieve individual home ownership". The application also stated "The ORG-1 will conduct programs, for the benefit of underprivileged citizens, to enlighten them as to the values of individual home ownership and to assist them in securing private home ownership for themselves and their families".

The response to Question 1 continued by stating "The ORG-1 will institute a program whereby potential buyers, with limited funds, will be provided assistance in selecting homes which they will be able to acquire and maintain without unduly burdening their financial situation. The ORG-1 will institute a unique plan whereby properly educated, properly qualified purchasers will be able to secure monetary assistance with regard to investigation expenses, closing costs, down payments, etc., in the home buying process."

The organization also stated "Owners will be encouraged to participate by pledging financial support to the ORG-1 to secure the assistance of the ORG-1 in presenting pre-qualified purchasers for individual homes. All of the funds pledged to the ORG-1, shall be allocated for the direct benefit of worthy families to assist them in purchasing residential properties for family usage."

In Part II, Question 2, the organization stated that the sources of financial support would be the public, public foundations, corporations, small businesses and individuals.

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In Part II, Question 3, the organization described its fundraising program. It stated the program was being instituted through the use of volunteers and participating home industry organizations.

On November 5, 20XX, the IRS issued a letter to ORG-1 requesting additional information regarding the Form 1023 filed by the organization. In response to the question "What are the criteria for someone to participate in your program?", the organization stated that "The applicant must show sufficient creditworthiness to qualify for primary financing from a Licensed Mortgage Lender and our gift funds must be approved by the eligible loan program."

In response to the question "What kind of contributions will you be requiring of home sellers?" the organization responded that "A home seller or builder will be able to register their property and contribute between 2% and 5% of the sales price to the ORG-1. By registering the property with a set amount of contribution per property we can avoid any discrimination towards a particular buyer. Much like the CO-1 and CO-2 that has helped many thousands of families buy homes."

When asked "What requirements does this organization have for the home seller?", the organization stated that "The home seller must register the home and state the participation level to the foundation, whereas any prospective home buyer may be eligible for our gift."

Finally, the IRS noted that the organization, in Part II, Question 2 of Form 1023, had stated that it will receive financial support from the public, foundations, corporations, small businesses, and individuals and asked if this support would be donations and contributions. The organization replied that "The financial support referred to on page 2 will be primarily from donations with possibly some contributions. It is projected that the donations will come from home sellers."

The Service issued a favorable determination letter to the ORG-1 on December 3, 20XX. The determination letter stated that ORG-1 was exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). The letter also determined that the organization was not a private foundation with the meaning of section 509(a) of the Code, because it was described in sections 509(a)(1) and 170(b)(1)(A)(vi).

On November 27, 20XX, an amendment to the corporation's Articles of Incorporation was filed to change the organization's name from the ORG-1 to ORG

On April 21, 20XX, the IRS Ogden Service Center issued Letter 3606 to request information regarding the Form 990 filed by ORG for the year ending December 31, 20XX. The



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Form 990, Part III, Statement of Program Service Accomplishments for that year, had reported that the organization provided "assistance to low to middle home buyers."

One item requested by the Ogden Service Center in their letter of April 21, 20XX was a description of the organization's program including the funding sources and an explanation of the source of the gross receipts reported on Form 990.

ORG responded that it primarily has 5 programs. The programs consist of Pre-Homebuyer Education, Early Delinquency Counseling, a Mortgage Protection Plus Program, Post-Homebuyer Education and the Charitable Gift Program.

The Charitable Gift Program provides down payment grants to low-moderate income homebuyers who meet certain criteria (discussed below). The Gift Program allows the organization to generate service fee revenue from the home sellers that permits it to provide for the grants to homebuyers as well as to pay for all of the additional programs and services listed above.

The organization notes that while funding "will come from contributions received through solicitation from other non-profit organizations, private individuals, public and private businesses, the vast majority of the funding comes from home sellers who have agreed to make the contributions upon the sale of their homes."

The Guidelines for the following criteria for eligibility:

Charitable Gift Program list

- 1) Buyer must be securing a primary residence.
- 2) The Program is not restricted to first-time homebuyer's
- 3) Buyer must be approved for a mortgage
- 4) The mortgage program used by the buyer must be willing to accept gift funds from a non-profit organization.
- 5) The lender must be on the "Approved Lenders List" for ...
- 6) The buyer must be purchasing a home that is enrolled in the
- 7) Buyer's income must not exceed 140% of the median average for City or County in which they are purchasing a home. Should they exceed 140% of the median income, they are eligible to request an exception from the Foundation.
- 8) The Buyer must sign a "Gift Letter" with the ... which will acknowledge that the funds are not to be repaid and that the funds do not come from a related party to the transaction.
- 9) The Buyer is limited in the gift amount. They cannot receive a gift, which will exceed the specific lender guidelines.

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10) Gifts from \_\_\_\_\_ will not exceed 10% of the purchase price or \$. This amount can be less if the lender guidelines are more restrictive.

The Form 990 filed by ORG for the year ended December 31, 20XX reported Program service revenue of \$. Combined with \$680 of contributions, total revenue was \$. Program service revenue is described in Part VII of Form 990 as "participating home downpayment revenue". Therefore, 99% of revenues received were from home sellers. Program service expenses totaled \$ of which \$ was used for downpayment assistance gifts.

Based on the examination of the activities and financial information reported on the Form 990 return, ORG generated revenue and expended funds in furtherance of the operation of a down-payment assistance program. In Part III of the Form 990, Statement of Program Service Accomplishments, the organization wrote "To provide assistance to low to middle home buyers".

In a letter dated April 23, 20XX, CEO, CEO of \_\_\_\_\_ stated that "the vast majority of the funding comes from home sellers who have agreed to make the contributions upon the sale of their homes."

In a subsequent letter dated August 6, 20XX, CEO reiterated that "the vast majority of our revenue is derived from the service fees we receive from our down payment assistance program." He also noted that there are no fees or charges for the educational programs offered by the organization because the programs are "subsidized through the program service fee revenue we receive from our down payment assistance program."

#### LAW:

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings inures to the benefit of any private shareholder or individual. See § 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet



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this requirement it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" as used in § 501(c)(3) as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" as used in § 501(c)(3) relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

**Easter House v. US., Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir)**

The US Court of federal claims considered whether an organization that provided an adoption and related health services to pregnant woman who agreed to place their newborns for adoption through the organization qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operations of an adoption service which, in and of itself, did not serve an exempt purpose. The organization did not provide health-related services to unwed mothers who wished to keep their children or who arranged for an adoption independent of the organization. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of education and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). *Easter house*, 12 Cl. CT. at 485-86.

**American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989)**

The court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organizations graduates

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worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organizational "insiders", the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve private interests within the meaning of § 501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner. "American Campaign Academy", 92 T.C. at 1077.

**Columbia Park & Recreation Association v. Commissioner, 88 T.C. 1 (1987), aff'd. Without published opinion, 838 F.2<sup>nd</sup> 465 (4<sup>th</sup> Cir. 1988)**

The court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks and other recreational facilities did not qualify as § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes.

Rev. Rul. 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is "charitable" because it relieves the poor and distressed or underprivileged. In Rev. Rul. 67-138, the organization carried on several activities directed to assisting low-income families in obtaining improved housing, including (1) conducting a training course relative to various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and analyzed whether each organization qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families eligible for loans under a Federal housing program who did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low-income families did not qualify for exemption under § 501(c)(3) because it gave preference

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to employees of a business operated by the individual who also controlled the organization. Although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

Rev. Rul. 72-559, 1972-2 C.B. 247, held that an organization that subsidized recent law graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services, and to provide free legal services to needy members of the community, qualified for exemption under § 501(c)(3). Although the recipients of the subsidies were not themselves members of a charitable class, the resulting benefit to them did not detract from charitable purposes. Rather, the young lawyers were merely the instruments by which the organization accomplished the charitable purpose of providing free legal services for those unable to pay for, or obtain, such services.

Rev. Rul. 74-587, 1974-2 C.B. 162, held that an organization providing low-cost or long-term loans to, or equity investments in, businesses operating in economically depressed areas qualified for exemption under § 501(c)(3). The organization provided financial assistance only to businesses that were unable to obtain funds from conventional sources, and gave preference to businesses that would provide training and employment opportunities for unemployed or under-employed area residents. Although some of the individual business owners receiving financial assistance from the organization were not themselves members of a charitable class, the benefit to them did not detract from the charitable character of the organization's program. As in Rev. Rul. 72-559, the recipients of aid were instruments for accomplishing the organization's charitable purposes.

Rev. Rul. 76-419, 1976-2 C.B. 146, held that an organization that converts blighted land in an economically depressed community to an industrial park and leases space on favorable terms to businesses that agree to hire a significant number of unemployed area residents and train them in needed skills qualifies for exemption under § 501(c)(3). The organization furthered charitable purposes by improving economic conditions for the poor and distressed and combating community deterioration. The organization offered inducements to businesses solely for the purpose of advancing charitable goals.

### **EXAMPLE:**

#### **Situation #2**

Per Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, under Y's grant making procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which Y provides down payment assistance



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to a home buyer, Y receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by Y in connection with each of these transactions and the amount of the home seller's payment to Y. Finally, Y does not conduct a broad based fundraising campaign to attract financial support. Rather, most of Y's support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive Y's down payment assistance.

### **ANALYSIS:**

#### **Situation #2**

Per Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, Y does not qualify as an organization described in § 501(c)(3). To finance its down payment assistance activities, Y relies on sellers and other real-estate related businesses that stand to benefit from the transactions Y facilitates. Furthermore, in deciding whether to provide assistance to a low-income applicant, Y's grant making staff knows the identity of the home seller and may also know the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to Y. Y's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and Y's reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of Y's operations. In this respect, Y is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Like the organization considered in *American Campaign Academy*, Y is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, Y also serves an exempt purpose, but because Y is not operated exclusively for exempt purposes, Y does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

#### **GOVERNMENT'S POSITION:**

Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, Situation #2, outlined above most closely identifies down payment assistance program. In its analysis, it clearly shows ORG not qualifying as an organization described in § 501(c)(3). To finance its down payment assistance activities, ORG relies on seller funding to finance its down payment assistance activities. The organization's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and reliance on these payments for most of its funding (99%) indicate that the benefit to the home seller is a critical aspect of the organization's operations. In this respect, ORG is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any

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educational or charitable purpose. Like the organization considered in *American Campaign Academy*, ORG is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, ORG also serves an exempt purpose, but because ORG is not operated exclusively for exempt purposes, ORG does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

The conclusion that ORG is not operated as a "charitable" organization within the meaning of Federal Tax Regulations § 1.501(c)(3)-1(c) rests primarily on an analysis of its sources of revenue and its business activities. Based on the rationale described in Revenue Ruling 20XX- 27 I.R.B. 20XX-21, May 4, 20XX, organizations that provide seller-funded down payment assistance to low-income homebuyers do not qualify as tax-exempt charities.

#### **TAXPAYER'S POSITION:**

On June 21, 20XX, Information Document Request 002 was issued to the organization. The IDR asked ORG to distinguish its operations from those described in Situation 2 of Revenue Ruling 20XX-27. No reply has been received.

#### **CONCLUSION:**

ORG is not operated exclusively for charitable purposes, and, consequently, does not qualify for exemption from federal income tax as an organization described in I.R.C. § 501(c)(3) of the Internal Revenue Code and § 1.501(c)(3)-1(c)(1); § 1.501(c)(3)-1(d)(1)(ii); § 1.501(c)(3)-1(d)(2); § 1.501(c)(3)-1(d)(3)(i); § 1.501(c)(3)-1(e) of the Income Tax Regulations.



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**ISSUES:**

1. Whether an organization, whose primary purpose is operating a "down-payment assistance" program is operated exclusively for charitable purposes within the meaning of IRC 501(c)(3)?

**FACTS:**

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The response to Question 1 continued by stating "The ORG-1 will institute a program whereby potential buyers, with limited funds, will be provided assistance in selecting homes which they will be able to acquire and maintain without unduly burdening their financial situation. The ORG-1 will institute a unique plan whereby properly educated, properly qualified purchasers will be able to secure monetary assistance with regard to investigation expenses, closing costs, down payments, etc., in the home buying process."

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In Part II, Question 3, the organization described its fundraising program. It stated the program was being instituted through the use of volunteers and participating home industry organizations.

On November 5, 20XX, the IRS issued a letter to ORG-1 requesting additional information regarding the Form 1023 filed by the organization. In response to the question "What are the criteria for someone to participate in your program?", the organization stated that "The applicant must show sufficient creditworthiness to qualify for primary financing from a Licensed Mortgage Lender and our gift funds must be approved by the eligible loan program."

In response to the question "What kind of contributions will you be requiring of home sellers?" the organization responded that "A home seller or builder will be able to register their property and contribute between 2% and 5% of the sales price to the ORG-1. By registering the property with a set amount of contribution per property we can avoid any discrimination towards a particular buyer. Much like the CO-1 and CO-2 that has helped many thousands of families buy homes."

When asked "What requirements does this organization have for the home seller?", the organization stated that "The home seller must register the home and state the participation level to the foundation, whereas any prospective home buyer may be eligible for our gift."

Finally, the IRS noted that the organization, in Part II, Question 2 of Form 1023, had stated that it will receive financial support from the public, foundations, corporations, small businesses, and individuals and asked if this support would be donations and contributions. The organization replied that "The financial support referred to on page 2 will be primarily from donations with possibly some contributions. It is projected that the donations will come from home sellers."

The Service issued a favorable determination letter to the ORG-1 on December 3, 20XX. The determination letter stated that ORG-1 was exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). The letter also determined that the organization was not a private foundation with the meaning of section 509(a) of the Code, because it was described in sections 509(a)(1) and 170(b)(1)(A)(vi).

On November 27, 20XX, an amendment to the corporation's Articles of Incorporation was filed to change the organization's name from the ORG-1 to ORG

On April 21, 20XX, the IRS Ogden Service Center issued Letter 3606 to request information regarding the Form 990 filed by ORG for the year ending December 31, 20XX. The

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Form 990, Part III, Statement of Program Service Accomplishments for that year, had reported that the organization provided "assistance to low to middle home buyers."

One item requested by the Ogden Service Center in their letter of April 21, 20XX was a description of the organization's program including the funding sources and an explanation of the source of the gross receipts reported on Form 990.

ORG responded that it primarily has 5 programs. The programs consist of Pre-Homebuyer Education, Early Delinquency Counseling, a Mortgage Protection Plus Program, Post-Homebuyer Education and the Charitable Gift Program.

The Charitable Gift Program provides down payment grants to low-moderate income homebuyers who meet certain criteria (discussed below). The Gift Program allows the organization to generate service fee revenue from the home sellers that permits it to provide for the grants to homebuyers as well as to pay for all of the additional programs and services listed above.

The organization notes that while funding "will come from contributions received through solicitation from other non-profit organizations, private individuals, public and private businesses, the vast majority of the funding comes from home sellers who have agreed to make the contributions upon the sale of their homes."

The Guidelines for the following criteria for eligibility:

Charitable Gift Program list

- 1) Buyer must be securing a primary residence.
- 2) The Program is not restricted to first-time homebuyer's
- 3) Buyer must be approved for a mortgage
- 4) The mortgage program used by the buyer must be willing to accept gift funds from a non-profit organization.
- 5) The lender must be on the "Approved Lenders List" for
- 6) The buyer must be purchasing a home that is enrolled in the "Charitable Gift Program".
- 7) Buyer's income must not exceed 140% of the median average for City or County in which they are purchasing a home. Should they exceed 140% of the median income, they are eligible to request an exception from the Foundation.
- 8) The Buyer must sign a "Gift Letter" with the which will acknowledge that the funds are not to be repaid and that the funds do not come from a related party to the transaction.
- 9) The Buyer is limited in the gift amount. They cannot receive a gift, which will exceed the specific lender guidelines.



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10) Gifts from \_\_\_\_\_ will not exceed 10% of the purchase price or \$. This amount can be less if the lender guidelines are more restrictive.

The Form 990 filed by ORG for the year ended December 31, 20XX reported Program service revenue of \$. Combined with \$680 of contributions, total revenue was \$. Program service revenue is described in Part VII of Form 990 as "participating home downpayment revenue". Therefore, 99% of revenues received were from home sellers. Program service expenses totaled \$ of which \$ was used for downpayment assistance gifts.

Based on the examination of the activities and financial information reported on the Form 990 return, ORG generated revenue and expended funds in furtherance of the operation of a down-payment assistance program. In Part III of the Form 990, Statement of Program Service Accomplishments, the organization wrote "To provide assistance to low to middle home buyers".

In a letter dated April 23, 20XX, CEO, CEO of \_\_\_\_\_ stated that "the vast majority of the funding comes from home sellers who have agreed to make the contributions upon the sale of their homes."

In a subsequent letter dated August 6, 20XX, CEO reiterated that "the vast majority of our revenue is derived from the service fees we receive from our down payment assistance program." He also noted that there are no fees or charges for the educational programs offered by the organization because the programs are "subsidized through the program service fee revenue we receive from our down payment assistance program."

#### **LAW:**

Section 501 of the Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable or educational purposes, provided that no part of the net earnings inures to the benefit of any private shareholder or individual. See § 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in § 501(c)(3). An organization must not engage in substantial activities that fail to further an exempt purpose. In *Better Business Bureau of Washington, D.C. v. U.S.*, 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet

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this requirement it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) defines the term "charitable" as used in § 501(c)(3) as including the relief of the poor and distressed or of the underprivileged, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, to eliminate prejudice and discrimination, or to combat community deterioration. The term "charitable" also includes the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" as used in § 501(c)(3) relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of § 501(c)(3) if the trade or business furthers an exempt purpose, and if the organization's primary purpose does not consist of carrying on an unrelated trade or business.

**Easter House v. US., Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir)**

The US Court of federal claims considered whether an organization that provided an adoption and related health services to pregnant woman who agreed to place their newborns for adoption through the organization qualified for exemption under § 501(c)(3). The court concluded that the organization did not qualify for exemption under § 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health-related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operations of an adoption service which, in and of itself, did not serve an exempt purpose. The organization did not provide health-related services to unwed mothers who wished to keep their children or who arranged for an adoption independent of the organization. The organizations sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of education and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in § 501(c)(3). Easter house, 12Cl. CT. at 485-86.

**American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989)**

The court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in § 501(c)(3) because it served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with a particular political party and that most of the organizations graduates



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worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organizational "insiders", the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve private interests within the meaning of § 501(c)(3)-1(d)(1)(ii). The court concluded by stating that even if the political party's candidates and entities did comprise a charitable class, [the organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner. "American Campaign Academy", 92 T.C. at 1077.

**Columbia Park & Recreation Association v. Commissioner, 88 T.C. 1 (1987), aff'd. Without published opinion, 838 F.2<sup>nd</sup> 465 (4<sup>th</sup> Cir. 1988).**

The court held that an association formed in a private real estate development to operate parks, swimming pools, boat docks and other recreational facilities did not qualify as § 501(c)(3) organization. Although the organization provided some benefit to the general public, the primary intended beneficiaries were the residents and property owners of the private development. Thus, the organization operated for a substantial non-exempt purpose rather than for exclusively charitable purposes.

Rev. Rul. 67-138, 1967-1 C.B. 129, held that helping low-income persons obtain adequate and affordable housing is "charitable" because it relieves the poor and distressed or underprivileged. In Rev. Rul. 67-138, the organization carried on several activities directed to assisting low-income families in obtaining improved housing, including (1) conducting a training course relative to various aspects of homebuilding and homeownership, (2) coordinating and supervising joint construction projects, (3) purchasing building sites for resale at cost, and (4) lending aid in obtaining home construction loans.

Rev. Rul. 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and analyzed whether each organization qualified as charitable within the meaning of § 501(c)(3). Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to low-income families eligible for loans under a Federal housing program who did not have the necessary down payment. The organization made rehabilitated homes available to families who could not qualify for any type of mortgage. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Rev. Rul. 72-147, 1972-1 C.B. 147, held that an organization that provided housing to low-income families did not qualify for exemption under § 501(c)(3) because it gave preference

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to employees of a business operated by the individual who also controlled the organization. Although providing housing for low-income families furthers charitable purposes, doing so in a manner that gives preference to employees of the founder's business primarily serves the private interest of the founder rather than a public interest.

Rev. Rul. 72-559, 1972-2 C.B. 247, held that an organization that subsidized recent law graduates during the first three years of their practice to enable them to establish legal practices in economically depressed communities that have a shortage of available legal services, and to provide free legal services to needy members of the community, qualified for exemption under § 501(c)(3). Although the recipients of the subsidies were not themselves members of a charitable class, the resulting benefit to them did not detract from charitable purposes. Rather, the young lawyers were merely the instruments by which the organization accomplished the charitable purpose of providing free legal services for those unable to pay for, or obtain, such services.

Rev. Rul. 74-587, 1974-2 C.B. 162, held that an organization providing low-cost or long-term loans to, or equity investments in, businesses operating in economically depressed areas qualified for exemption under § 501(c)(3). The organization provided financial assistance only to businesses that were unable to obtain funds from conventional sources, and gave preference to businesses that would provide training and employment opportunities for unemployed or underemployed area residents. Although some of the individual business owners receiving financial assistance from the organization were not themselves members of a charitable class, the benefit to them did not detract from the charitable character of the organization's program. As in Rev. Rul. 72-559, the recipients of aid were instruments for accomplishing the organization's charitable purposes.

Rev. Rul. 76-419, 1976-2 C.B. 146, held that an organization that converts blighted land in an economically depressed community to an industrial park and leases space on favorable terms to businesses that agree to hire a significant number of unemployed area residents and train them in needed skills qualifies for exemption under § 501(c)(3). The organization furthered charitable purposes by improving economic conditions for the poor and distressed and combating community deterioration. The organization offered inducements to businesses solely for the purpose of advancing charitable goals.

### **EXAMPLE:**

#### **Situation #2**

Per Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, under Y's grant making procedures, Y's staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which Y provides down payment assistance



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to a home buyer, Y receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by Y in connection with each of these transactions and the amount of the home seller's payment to Y. Finally, Y does not conduct a broad based fundraising campaign to attract financial support. Rather, most of Y's support comes from home sellers and real estate-related businesses that may benefit from the sale of homes to buyers who receive Y's down payment assistance.

### **ANALYSIS:**

#### **Situation #2**

Per Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, Y does not qualify as an organization described in § 501(c)(3). To finance its down payment assistance activities, Y relies on sellers and other real-estate related businesses that stand to benefit from the transactions Y facilitates. Furthermore, in deciding whether to provide assistance to a low-income applicant, Y's grant making staff knows the identity of the home seller and may also know the identities of other interested parties and is able to take into account whether the home seller or another interested party is willing to make a payment to Y. Y's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and Y's reliance on these payments for most of its funding indicate that the benefit to the home seller is a critical aspect of Y's operations. In this respect, Y is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any educational or charitable purpose. Like the organization considered in *American Campaign Academy*, Y is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, Y also serves an exempt purpose, but because Y is not operated exclusively for exempt purposes, Y does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

### **GOVERNMENT'S POSITION:**

Internal Revenue Bulletin 20XX-21, May 22, 20XX, Revenue Ruling 20XX-27, Situation #2, outlined above most closely identifies down payment assistance program. In its analysis, it clearly shows ORG not qualifying as an organization described in § 501(c)(3). To finance its down payment assistance activities, ORG relies on seller funding to finance its down payment assistance activities. The organization's receipt of a payment from the home seller corresponding to the amount of the down payment assistance in substantially all of the transactions, and reliance on these payments for most of its funding (99%) indicate that the benefit to the home seller is a critical aspect of the organization's operations. In this respect, ORG is like the organization considered in *Easter House*, which received all of its support from fees charged to adoptive parents, so that the business purpose of the adoption service became its primary goal and overshadowed any

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educational or charitable purpose. Like the organization considered in *American Campaign Academy*, ORG is structured and operated to assist private parties who are affiliated with its funders. Like the organizations considered in *American Campaign Academy*, *Easter House*, and *Columbia Park Recreation Association*, ORG also serves an exempt purpose, but because ORG is not operated exclusively for exempt purposes, ORG does not qualify for exemption from federal income tax as an organization described in § 501(c)(3).

The conclusion that ORG is not operated as a "charitable" organization within the meaning of Federal Tax Regulations § 1.501(c)(3)-1(c) rests primarily on an analysis of its sources of revenue and its business activities. Based on the rationale described in Revenue Ruling 20XX-27 I.R.B. 20XX-21, May 4, 20XX, organizations that provide seller-funded down payment assistance to low-income homebuyers do not qualify as tax-exempt charities.

#### **TAXPAYER'S POSITION:**

On June 21, 20XX, Information Document Request 002 was issued to the organization. The IDR asked ORG to distinguish its operations from those described in Situation 2 of Revenue Ruling 20XX-27. No reply has been received.

#### **CONCLUSION:**

ORG is not operated exclusively for charitable purposes, and, consequently, does not qualify for exemption from federal income tax as an organization described in I.R.C. § 501(c)(3) of the Internal Revenue Code and § 1.501(c)(3)-1(c)(1); § 1.501(c)(3)-1(d)(1)(ii); § 1.501(c)(3)-1(d)(2); § 1.501(c)(3)-1(d)(3)(i); § 1.501(c)(3)-1(e) of the Income Tax Regulations.